

# Report of the auditor-general to KwaZulu-Natal Provincial Legislature and the council on Mpofana Local Municipality

## Report on the audit of the financial statements

### Disclaimer of opinion

1. I was engaged to audit the financial statements of the Mpofana Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2019, the statement of financial performance, statement of changes in net assets and cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. I do not express an opinion on the financial statements of the municipality. Because of the significance of the matters described in the basis for disclaimer of opinion section of this auditor's report, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

### Basis for disclaimer of opinion

#### Property, plant and equipment

3. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for property, plant and equipment due to the status of accounting records. I was unable to confirm the property, plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to property, plant and equipment stated at R150,44 million (2017-18 R145,53 million) in note 4 to the financial statements.

#### Investment property

4. The municipality did not account for investment property in accordance with the *GRAP 16 Investment property*. Certain items of investment property were recorded at incorrect amounts. Additionally, the municipality did not record all items that met the definition of investment property. I was unable to determine the impact on investment property as it was impracticable to do so. Consequently, investment property stated at R22,95 million (2017-18: R23,61 million) in note 3 to the financial statements is misstated by an undeterminable amount. Additionally, there was an impact on the deficit for the period and on the accumulated surplus.

#### Receivables from non-exchange transactions

5. I was unable to obtain sufficient appropriate audit evidence for the disclosure of receivables from non-exchange transactions and the ageing of receivables from non-exchange transactions as the system of recording the receivables from non-exchange transactions could not be reconciled to the financial statements. The municipality was unable to provide evidence for the assessment of receivables from non-exchange transactions, individually or by category, for any indicators that these debtors may be impaired at reporting date. I could not confirm the ageing by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to the receivables from non-exchange transactions stated at R84,85 million (2017-18 R80,83 million) and the allowance for impairment of receivables from non-exchange transactions stated at R56,08 million (2017-18 R51,33 million) as disclosed in note 10 to the financial statements.

### Receivables from exchange transactions

6. I was unable to obtain sufficient appropriate audit evidence for the disclosure of receivables from exchange transactions and the ageing of receivables from exchange transactions as the system of recording the receivables from exchange transactions could not be reconciled to the financial statements. The municipality was unable to provide evidence for the assessment of receivables from exchange transactions, individually or by category, for any indicators that these debtors may be impaired at reporting date. I could not confirm the ageing by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to the receivables from exchange transactions stated at R112,55 million (2017-18 R80,32 million) and the allowance for impairment of receivables from exchange transactions stated at R68,41 million (2017-18 R51,05 million) as disclosed in note 12 to the financial statements.

### VAT receivable

7. The municipality did not correctly account for the VAT input and output from expenditure and revenue transactions respectively due to the internal control system incorrectly accounting for VAT transactions. Consequently, VAT receivable stated at R14,99 million (2017-18 R5,58 million) in note 11 to the financial statements was misstated by an amount that is impractical to determine.

### Payables from exchange transactions

8. I was unable to obtain sufficient appropriate audit evidence for payables from exchange transactions due to the status of accounting records of the payables register. The municipality did not have adequate systems of internal control for the recording of payables and could not reconcile payables to the financial statements. I could not confirm payables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to payables from exchange transactions stated at R182,46 million (2017-18: R119,69 million) as disclosed in note 17 to the financial statements.

### Unspent conditional grants and receipts

9. The municipality did not correctly account for all grant expenditure in accordance with the conditions of the grants. The unspent conditional grants were reduced by expenditure payments that did not meet the conditions of the grants. Consequently, unspent conditional grants and receipts stated at R15,26 million (2017-18 R16,62 million) is understated by an amount which is impractical to determine.

### Provision for leave pay

10. I was unable to obtain sufficient appropriate audit evidence that the municipality correctly accounted for the provision for leave pay as the system of internal control supporting leave transactions was not effective. I could not confirm the provision for leave pay by alternative means. Consequently, provision for leave pay as stated at R3,59 million (2017-18 R3,55 million) in note 16 to the financial misstatements is misstated by an amount which is impractical to determine.

### Revenue – Service charges

11. I was unable to obtain sufficient appropriate audit evidence for revenue from service charges due to the status of accounting records. I was unable to confirm the revenue from service charges by alternative means. Additionally, the comparative figure for service charges disclosed in the financial statements did not agree to the underlying supporting records. Consequently, I was unable to determine whether any adjustment was necessary to revenue from service charges stated at R76,05 million (2017-18 R64,99 million) in the financial statements. The related receivable is further misstated by an amount which is impractical to determine.



## Interest received – Investment

12. I was unable to obtain sufficient appropriate audit evidence that the municipality adequately accounted for interest from receivables from exchange and non-exchange transactions in accordance with *GRAP 9 Revenue from exchange transactions* and *GRAP 23 Revenue from non-exchange transactions*. The municipality did not charge interest on all overdue accounts. I was unable to determine the full extent of the misstatement as it was impractical to do so. Consequently, interest revenue from receivables and interest revenue from non-receivables stated at R509,212 (2017-18 R4,09 million) as disclosed in note 23 to the financial statements was misstated. The related receivable is further misstated by an amount which is impractical to determine.

## Revenue – Fines

13. The municipality did not record all revenue relating to traffic fines in accordance with *GRAP 23 Revenue from non-exchange transactions*. The municipality did not have adequate systems of internal control in place for the recording of the revenue from traffic fines. Consequently, revenue from traffic fines stated at R25,535 (2017-18 R12,80 million) and the related receivable is understated by an amount which is impractical to determine.

## Expenditure

14. I was unable to obtain sufficient appropriate audit evidence for general expenses and contracted services as disclosed in the statement of financial performance due to the status of accounting records. The municipality was unable to provide supporting information to validate adjustments to these expenditure accounts. I could not confirm this expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to general expenses stated at R41,30 million and contracted services stated R4.44 million was necessary.
15. The municipality did not correctly classify all expenditure relating to finance leases in accordance with *GRAP 13 Leases*. The municipality was party to a number of lease agreements that constituted finance leases which were incorrectly accounted for as operating leases. General expenses as per note 34 incorrectly included amounts relating to finance leases.

## Irregular expenditure

16. The municipality did not include all irregular expenditure in the notes to the financial statements, as required by section 125(2)(d) of the MFMA as the municipality did not maintain an adequate system to record all items that constituted irregular expenditure. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm the irregular expenditure included in the notes to the financial statements as sufficient appropriate audit evidence was not provided. I was unable to confirm this by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure stated at R78,87 million (2017-18 R52,70 million) in note 46 to the financial statements.

## Unauthorised expenditure

17. The municipality did not include all unauthorised expenditure in the notes to the financial statements, as required by section 125(2)(d) of the MFMA as the municipality did not maintain an adequate system to record all items that constituted unauthorised expenditure. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm the unauthorised expenditure included in the notes to the financial statements as sufficient appropriate audit evidence was not provided. I was unable to confirm this by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the unauthorised expenditure stated at R128,53 million (2017-18 R117,49 million) in note 44 to the financial statements.

### Fruitless and wasteful expenditure

18. The municipality did not include all fruitless and wasteful expenditure in the notes to the financial statements, as required by section 125(2)(d) of the MFMA as the municipality did not maintain an adequate system to record all items that constituted fruitless and wasteful expenditure. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm the fruitless and wasteful expenditure included in the notes to the financial statements as sufficient appropriate audit evidence was not provided. I was unable to confirm this by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the fruitless and wasteful expenditure stated at R12,98 million (2017-18 R4,82 million) in note 45 to the financial statements.

### Commitments

19. The municipality did not recognise all items that constituted capital and operational commitments. The financial statements disclosure for capital and operational commitments was not supported by the commitment registers. Consequently, capital and operational commitments stated at R34,37 million (2017-18 R19,85 million) and R38,43 million (2017-18 R34,16 million) respectively in note 37 to the financial statements was misstated by an amount that was impractical to determine.

### Prior period errors

20. I was unable to obtain sufficient appropriate audit evidence for the prior period errors in note 40 to the financial statements due to the status of accounting records I could not confirm these disclosures by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the prior period errors disclosed in the financial statements.

### Electricity losses

21. The municipality did not accurately disclose the narrative information related to electricity losses in note 49 to the financial statements. Consequently, the narrative disclosures of electricity losses were misstated by R6,39 million (2017-18 R7,09 million).

### Statement of changes in net assets

22. I was unable to obtain sufficient appropriate audit evidence for the accumulated surplus disclosed in the financial statements as the opening balance of the accumulated surplus was misstated. Consequently, I was unable to determine whether any adjustments to the accumulated surplus of R27,31 million disclosed in the statement of changes in net assets was necessary.

### Cash flow statement

23. The municipality did not accurately account for cash flow from operating activities. The municipality included the incorrect interest revenue in the calculation of cash flow from operating activities. Additionally, the municipality did not correctly disclose the prior year cash flow from operating, investing and financing activities. Consequently, the cash flow is misstated by an amount which is impractical to determine.

### Statement of comparison of budget and actual amounts

24. The municipality did not accurately account for the budget amounts included in the statement of comparison between budget and actual amounts as the amounts disclosed in the budget statement did not agree to the final approved budget. Consequently, the variances between the actual and budgeted amounts as disclosed in the statement of comparison of budget and actual amounts, does not reflect the actual variances.



## **Context for the opinion**

25. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
26. I am independent of the municipality in accordance with sections 290 and 291 of the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* and, parts 1 and 3 of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA codes) as well as the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA codes.
27. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my disclaimer of opinion.

## **Material uncertainty relating to going concern/ financial sustainability**

28. I draw attention to the matter below. My opinion is not modified in respect of this matter.
29. We draw attention to note 42 to the financial statements, which indicates that unspent conditional grants are not fully cash backed and current liabilities exceed the current assets. As stated in note 42, these events or conditions, along with the other matters as set forth in note 42, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.

## **Emphasis of matter**

30. I draw attention to the matter below. My opinion is not modified in respect of this matter.

## **Restatement of corresponding figures**

31. As disclosed in note 40 to the financial statements, the corresponding figures for 30 June 2018 were restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2019.

## **Other matter**

32. I draw attention to the matter below. My opinion is not modified in respect of this matter.

## **Unaudited disclosure notes**

33. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

## **Responsibilities of the accounting officer for the financial statements**

34. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of

Revenue Act of South Africa, 2018 (Act No. 1 of 2018) (Dora) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

35. In preparing the financial statements, the accounting officer is responsible for assessing the Mpfana Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

### **Auditor-general's responsibilities for the audit of the financial statements**

36. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
37. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

## **Report on the audit of the annual performance report**

### **Introduction and scope**

38. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for the selected objective presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
39. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators / measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
40. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the Municipal basic service delivery objective presented in the annual performance report of the municipality for the year ended 30 June 2019.
41. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
42. I did not raise any material findings on the usefulness and reliability of the reported performance information for the municipal basic service delivery objective.



## Other matters

43. I draw attention to the matters below.

### Achievement of planned targets

44. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year.

### Adjustment of material misstatements

45. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the Municipal basic service delivery objective. As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness and reliability of the reported performance information.

## Report on the audit of compliance with legislation

### Introduction and scope

46. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

47. The material findings on compliance with specific matters in key legislations are as follows:

### Annual financial statements

48. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer audit opinion.

### Expenditure management

49. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

50. Payments were made from the municipality's bank account without the approval of the accounting officer / the chief financial officer / a properly authorised official, as required by section 11(1) of the MFMA.

51. Reasonable steps were not taken to ensure that the municipality implements and maintains an effective system of expenditure control, including procedures for the approval / authorisation / withdrawal / payment of funds, as required by section 65(2)(a) of the MFMA.

52. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the irregular expenditure could not be quantified as indicated in the basis for disclaimer paragraph.

53. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R10,28 million as disclosed in note 45 to the annual financial statements, in contravention of

section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest and penalty charges for late payments to suppliers.

54. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the unauthorised expenditure could not be quantified as indicated in the basis for disclaimer paragraph.

### Revenue management

55. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
56. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

### Asset management

57. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

### HR Management

58. The municipal manager and senior managers did not sign performance agreements within the prescribed period, as required by section 57(2)(a) of the MSA.

### Consequence management

59. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
60. Fruitless and wasteful expenditure and irregular expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA

### Procurement management

61. Some goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of municipal supply chain management regulation (MSCM regulation) 17(a) and (c).
62. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by MSCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of MSCM regulation 36(1). Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the appointment of the panel of consultants for electrical consultant projects.
63. Some of the invitations for competitive bidding were not advertised for a required minimum period of days, in contravention of MSCM regulation 22(1) and 22(2). Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement of the appointment of a panel of attorney for provision of legal services.
64. Some of the contracts were awarded through a competitive bidding processes that were not adjudicated by the bid adjudication committee. Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the appointment of a panel of consultants for electrical consultant projects.



65. Some of the competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with MSCM regulation 29(2). Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the appointment of a panel of consultants for electrical consultant projects.
66. Bid documentation for procurement of commodities designated for local content and production, did not stipulate the minimum threshold for local production and content as required by the 2017 preferential procurement regulation 8(2).
67. Commodities designated for local content and production, were procured from suppliers who did not submit a declaration on local production and content as required by the 2017 preferential procurement regulation.
68. Commodities designated for local content and production, were procured from suppliers who did not meet the prescribed minimum threshold for local production and content, as required by the 2017 preferential procurement regulation 8(5).
69. Some of the contracts were extended or modified without the approval of a properly delegated official, in contravention of MSCM regulation 5. Similar non-compliance was also reported in the prior year.

#### Other information

70. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report which includes the audit committee's report. The other information does not include the financial statements, the auditor's report and the selected objective presented in the annual performance report that have been specifically reported in this auditor's report.
71. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
72. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected objective presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
73. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report. However, if it is corrected this will not be necessary.

#### Internal control deficiencies

74. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the disclaimer opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
75. Leadership did not provide adequate oversight over financial and performance reporting. Compliance with legislation was not effective to ensure findings were prevented. Furthermore,

vacancies existed in key positions which resulted in the inability to drive the action plan to ensure improvement in audit outcomes and to hold persons accountable.

76. Management did not ensure that a proper records management system and a basic internal control management system was implemented to mitigate deficiencies in various areas to ensure credible and reliable financial reporting as well as compliance with laws and regulations.

#### Other reports

77. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
78. An independent consultant investigated an allegation of possible financial misconduct at the request of the KwaZulu-Natal Department of Cooperative Governance and Traditional Affairs, which covered the period 01 February 2011 to 30 June 2018. The investigation was concluded on 01 November 2018 and recommends disciplinary hearings and criminal proceedings against the parties involved.

*Auditor - General*

Pietermaritzburg

31 January 2020



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*



## **Annexure – Auditor-general’s responsibility for the audit**

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected objective and on the municipality’s compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the financial statements as described in this auditor’s report, I also:
  - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
  - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality’s internal control
  - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
  - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Mpofana Local Municipality ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a municipality to cease continuing as a going concern
  - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

### **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.